Inflation Quarterly Review transcript

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Since the beginning of the year, total inflation has been decelerating at a very fast pace. The main reason is the fall in energy prices. However, what is actually puzzling central banks today is the high level of core inflation.

Core inflation is inflation that excludes volatile components such as energy and food prices, and this one is well above the 2% target. It's actually around 5% in the US, in the UK and in the euro area.

So to fight against this high level of core inflation, central banks have kept on tightening their monetary policy. And as a matter of fact, the Bank of England surprised markets by raising its rates by 50 basis points. We do believe that this additional hike would actually slow down future growth.

So what to do and how to invest in this moment?

We do believe that inflation-linked bonds are an opportunity in this context.
First is the actual level of real yields. Real yields are the rate that you get on top of realized inflation. And for the first time since Lehman, since the great financial crisis, this interest rate is on positive territory.

And that in every market: US, UK and the euro area. So even if inflation decelerates, you're getting a real positive rate. The second argument is that the breakeven rate is too low. It's actually the lowest since the beginning of the year and is at 2%. The breakeven rate of the market-based inflation expectations is pricing zero upside risk over the medium term. The market thinks that the central banks are getting inflation down to target and given the macroeconomic context, we think that this assumption is very optimistic.

So in conclusion, because we have real rates that are extremely high and breakeven rates that are too low, we do believe that inflation-linked bonds of either short term and longer maturities are a great option for the second half of the year.

Source: AXA IM as of July 2023

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